BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
MARK IV METAL PRODUCTS, INC.)

For Appellant: Steven S. Glick
Certified Public Accountant

For Respondent: Michael E. Brownell
Counsel

O P I N I O N

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Mark IV Metal Products, Inc., against proposed assessments of additional franchise tax in the amounts of $638.00 and $333.00 for the income years ended March 31, 1976 and March 31, 1977, respectively.

The question presented by this appeal is whether respondent properly included income from sales to a Texas company in appellant's income taxable by California.

Appellant is a small California manufacturing corporation which makes tables and chairs from metal. One of its principal customers during the appeal years was a company located in Texas ("the Texas company"). The Texas company shipped unfinished steel to appellant which fabricated the metal into seat parts at its facilities in California. The finished parts were then shipped by common carrier back to the Texas company, which incorporated them into metal seats for sale to its own customers. Appellant never held title to the metal or the metal products.

This business relationship was apparently begun when the owner of the Texas company visited appellant's principal owner, Mr. Mark, at his place of business in California. Appellant had no sales or service offices, agents, or solicitors in Texas and did no advertising there. Transactions were ordinarily initiated by purchase orders mailed to appellant from the Texas company.

On its California franchise tax returns for the appeal years, appellant used formula apportionment to determine its California income. All of its property and payroll were reported as in California, but the sales to the Texas company were excluded from the numerator of the sales factor, resulting in apportionment of part of its income outside California. Upon audit, respondent determined that all of appellant's income was derived from sources within California and, therefore, none of it should have been apportioned outside California. Proposed assessments were issued reflecting the inclusion of all of appellant's net income in its California taxable income.

The basic measure of the franchise tax imposed on each corporation doing business within California is its entire net income, from whatever source derived. (Rev. & Tax. Code, § 23151, subd. (a), § 24271, § 24341; cf. Matson Nav. Co. v. State Bd. of Equal-ization, 3 Cal.2d1[43 P.2d 805](1935), affd., 297 U.S. 441 [80 L.Ed. 791] (1936) (income from interstate commerce).) However, if a taxpayer has income from sources within California and from sources outside California, its California franchise tax liability is measured only by the net income derived from or attributable to sources within this state. (Rev. & Tax. Code, § 25101.) When a taxpayer conducts a single unitary business both within and without this state, its business income is divided between states by means of an apportion-

ment formula to determine that portion which has its source in this State. (Cal. Admin. Code, tit. 18, reg. 25101, subd. (f) and reg. 25121 (art. 2.5).) A taxpayer may apportion its income, therefore, only if it has income from sources both within and without this state.

Respondent has determined that appellant could not apportion any of its income to Texas because its entire income was derived from sources within California. On the record before us, we must agree with respondent's determination.

Appellant had no employees, agents, salesmen, service personnel, real property, or tangible or intangible personal property in Texas. It did no solicitation or advertising in Texas. Communication with Texas was by common carrier and the mail. All of appellant's fabrication of metal parts was done in California. It did not own the metal which it fabricated and did not own the parts made from the metal. Apparently, all orders for labor were accepted in California and all payments were received here. It neither did nor owned anything in Texas which led to the income in question. In short, appellant has presented no facts which show that its income had any other source than California.

Appellant contends that Revenue and Taxation Code section 25135 and Public Law 86-272 (15 U.S.C.A. §§ 381-385) support its contention that the income from its sales to the Texas company was attributable to Texas. Neither of these statutes, however, is relevant to appellant's situation. Both deal solely with sales of tangible personal property. The income here was from appellant's provision of services. As appellant stated in its brief, "this material was [the Texas company's] own material" and appellant acted merely as "a sub-contractor to fabricate the metal by the use of [its] own labor and machinery." Because sales of services were involved, rather than sales of tangible personal property, appellant's reliance on section 25135 and P.L. 86-272 is misplaced.

The correctness of respondent's determination is further supported by the result which apportionment would have produced if it had been allowed. A taxpayer's business income is apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor and the denominator of which is three. (Rev. & Tax. Code, § 25128.) The numerators of the respective factors

are composed of the taxpayer's property, payroll, and sales in California; the denominators consist of the taxpayer's property, payroll, and sales everywhere. (Rev. & Tax. Code, §§ 25129, 25131, and 25134.)

We have already determined that the sales in question were sales of services, not sales of tangible personal property. Sales other than sales of tangible personal property are in California if the income-producing activity is performed in this state. (Rev. & Tax. Code, § 25136, subd. (a).) Appellant's income-producing activity was the fabrication of metal seat parts, which took place in California. These sales, therefore, were in California and includable in the numerator of the sales factor. All other sales, as well as all of appellant's payroll and property, were included in the numerators of the respective factors by appellant itself. Therefore, 100 percent of appellant's net business income would be apportioned to California even if appellant had been allowed to use formula apportionment.

Respondent's action, therefore, is sustained.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Mark IV Metal Products, Inc. against proposed assessments of additional franchise tax in the amounts of $638.00 and $333.00 for the income years ended March 31, 1976 and March 31, 1977, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 17th day of August, 1982, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Collis, Mr. Dronenburg and Mr. Nevins present.

William M. Bennett, Chairman

Ernest J. Dronenburg, Jr., Member

Richard Nevins, Member

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